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## REGULATION OF THE ANDEAN INVESTMENT CODE: COLOMBIA

DOMINIC A. PERENZIN\*

On May 26, 1969 Colombia, Chile, Bolivia, Ecuador and Perú signed the Agreement on Andean Subregional Integration (Cartagena Agreement) and formed the Andean Subregional Common Market (ANCOM).<sup>1</sup> Pursuant to Articles 26 and 27 of the Cartagena Agreement ANCOM's governing body, the Commission, issued Decision 24 titled "Common Rules Governing the Treatment of Foreign Capital, Trademarks, Patents, Licenses and Royalties" to be applied in ANCOM. Remarkably stringent rules were set out governing foreign investments in the Region. On June 30, 1971, Colombia issued Decree 1299 which was the internal implementation of Decision 24.

Each ANCOM member is authorized to issue its own set of regulations of Decision 24 or, in the case of at least Colombia, of the internal law implementing the decision. Much speculation arose as to whether and to what extent the ANCOM countries would, in regulating Decision 24 take a softer line and, in the view of some observers thus indicate a tendency on the part of each country to go its own way in strict obedience to national exigencies or conveniences.

After a seemingly endless period of silence, Colombia on November 5, 1971 issued Decree 2153 regulating Decree 1299. It is our intent in this Article to examine these regulations to determine where Colombia stands vis-à-vis Decision 24. It will be assumed that the reader is familiar with the contents of Decision 24.

As a preface to the analysis we would point out that in adopting Decree 1299, Colombia made some departures from Decision 24.

1. Article 3 subsection "c" which allows the acquisition by a foreign investor of shares owned by Colombian nationals to avoid the

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imminent bankruptcy of the company was modified by extending the term over which the foreign investor must divest himself of the shares from 10 to 15 years.

2. Article 17 was modified by allowing foreign companies access to local short term credit without the qualifications that this be exceptional.

3. The Article 34 preferential option given to a host country to acquire the shares of which a foreign company divested itself was eliminated.

In the following analysis of the Regulations our references will, for purposes of technical accuracy, be to Decree 1299 rather than to Decision 24.

### *Definitions*

Decree 1299 commences with a list of definitions of key concepts; the Regulations follow suit. Most of the definitions in the Decree are merely reiterated, but certain concepts are defined for the first time.

"Net profits" which may, subject to limitations be remitted abroad are defined as profits "produced in a given period by the normal operations of the company, after determination of taxes but before allocations to surplus accounts, including the legal reserve." Note the use of the qualification "normal operations." This concept is not defined nor explained in the Regulations, neither does it form part of Decree 1299 or Decision 24. It is not mentioned in Decree 1299 or Decision 24. It is not mentioned in Decree-Law 444 of 1967 which regulated the remittance of profits *ante* Decision 24. Are normal operations all those which are within the company's purpose clause or more limitedly are they those which have actually been conducted, thus rendering "un-normal" those activities which though the company is empowered to conduct have not in fact been engaged in? A second but narrower question is whether earnings from the sale of the company's assets could be considered net profits.<sup>2</sup> Apparently, unless these are held in the trade or business of the company they would not qualify.<sup>3</sup> If the capital assets are sold as part of the liquidation of the company, the gain could be transferred out of Colombia as a repatriation of capital.

The Regulations provide illustrations of those foreign direct investments (FDI's) which are made in local currency and which under the law give rise to the right of remittance abroad. These include profits, interest, principal of repatriable capital, royalties and fees for technical

services. Retained earnings which if distributed could have been remitted abroad also qualify as a FDI.

### *Competent Authorities*

Decree 1299 provides that certain procedures and acts must be conducted or performed before the competent authority of the State. Three such authorities are identified by the Regulations. The National Office of Planning has been given the key role of approving or rejecting foreign investments. The National Foreign Exchange Office will register approved investments, watchdog the compliance by foreign investors with the conditions of the investment, and impose sanctions for non-compliance. The Committee on Royalties is empowered to rule on the acceptability of contracts involving importation of technology relating to patents, trademarks, industrial processes, intangibles and commissions.

These assignments are highly commendable since the agencies are those which in the past have been charged with these same functions under Decree Law 444. This should help avoid organizational start-up delays in processing applications and registrations.

### *Valuation of a New Investment*

Article 11 sets forth rules determining the value of a new investment i.e., one made after June 1, 1971. Three forms of investments are referred to: foreign exchange; machinery, industrial plants and equipment; and reinvested earnings.

An investment made in the form of freely convertible foreign exchange is valued at the exchange rate prevailing on the date the local currency obtained from the central bank in exchange for the foreign currency is actually invested in a Colombian company.

An investment in the form of machinery, etc., is valued at the exchange rate existing on the date all documents required for valuation have been presented. If the Superintendency of Companies, which is charged with rendering the valuation, does not issue the valuation within sixty days following presentation of full documentation, the Office of Foreign Exchange is obligated to accept the foreign currency value appearing in or derived from the documentation.

In the case of machinery, etc., the investment will not be registered until proof is submitted showing that the items have been installed and

are at the service of the receiving company. This provision could prove important. Until such time as registration is effected the foreign investor has no right to remit profits or repatriate capital. The profits of the Company to which a right of remittance attaches are those generated from the date of investment registration.

Investments will be registered in freely convertible currencies (Article 8) and the value in such currency is the basis for both remittance of profits and repatriation of capital. Although this is certainly beneficial to the foreign investor, other factors militate against him namely, fairly high income tax rates,<sup>4</sup> continuous devaluation of the Colombian peso<sup>5</sup> and the fact that remittance and repatriation conversion from peso to foreign currency must be made at the rate prevailing on the date the transfers are made.<sup>6</sup>

#### *Reinvestment of Profits*

Article 15 reiterates the Decree rule that limits to 5% of the registered investment the amount of remittable profits which may, without authorization from the National Office of Planning, be reinvested and qualify for registration as a new investment. It adds, however, that no authorization is required to reinvest profits on the part of foreign investors in mixed or national companies.<sup>7</sup> The latter provision must be understood to operate within two broader rules. One defining a registerable direct foreign investment in the form of reinvested profits as the sums to which the investor has a right of remittance,<sup>8</sup> and the second prohibiting direct investments in mixed or national companies when as a consequence the mixed or national character is modified.<sup>9</sup>

#### *Remittable Profits*

An important legal issue is created by the Regulations in the area of remittance of profits. Decision 24, Decree 1299 and Article 16 of the Regulations provide a normal limitation of 14% of the amount of registered capital. However, where as the former laws permit the ANCOM Commission in special cases to increase this percentage at the request of a member country, Article 16 of the Regulations permits the increase (also in special cases) to be authorized by Colombia's National Council of Political and Social Policy. Is this part of Article 16 valid? It can only be so if there is read into it the tacit condition that prior Commission approval be obtained.

*Acquisition of Shares Owned by Local Stockholders*

A serious flaw in both Decision 24 and Decree 1299 vis-à-vis the implementation of the purpose of the investment code has been corrected in the Regulations. Article 3 of both the Decree and Decision 24 prohibits the acquisition by a *foreign investor* of shares held by a local investor, except when the acquisition is made to avoid the imminent bankruptcy of the company involved.

Since the provision refers to a "foreign investor" it opened up the possibility of a foreign investor creating a wholly owned foreign company in Colombia which would in turn acquire shares in a mixed or national company held by a local stockholder. The wholly owned company would not be a foreign investor as defined in Decision 24 and Decree 1299.

The Regulations have not only effectively eliminated this specific maneuver by prohibiting in Article 4 the acquisition of shares of local stockholders by *foreign or mixed* companies but have also prohibited the purchase of assets to achieve the same or similar results. In addition, mixed or national companies are prohibited from entering into mergers when as a result thereof the percentage of foreign capital in the new or surviving company is greater than it was in either of the companies forming part of the merger.

*Repatriation of Capital*

Potential problems for the foreign investor are created by the Regulations. Both Article 10 of the Decree 1299 and Article 14(a) of the Regulations provide for the right to repatriate the purchase price obtained from the sale of the foreign investor's shares. The Regulations, however, qualify this right.

When a foreign investor sells his shares or rights and receives an amount the equivalent of which in foreign exchange exceeds the net value of the registered investment and in the judgment of the Foreign Exchange Office there has been an overvaluation... an arbitration panel must be named to determine the real value of the shares or rights.<sup>10</sup>

The panel is to be comprised of four members, a representative from the Superintendency of Companies or, where applicable, the Banking Superintendency, the Advisory Board of Foreign Exchange, the National Department of Planning, and of the parties to the sales transaction. The

equivalent in foreign exchange of the amount in pesos fixed by the panel will be the maximum amount repatriable.

Important legal issues are presented by these Regulations. In providing for an official valuation and an arbitration panel, do the Regulations go beyond the limits of the law they are supposed to regulate? There are no limitations in Decision 24 or Decree 1299 on the price receivable nor the amount repatriable by a foreign investor on the sale of his shares. Let us assume that a government review of the valuation is legal. Then it seems that a second issue is raised. Both the Colombian Code of Civil Procedure and Commercial Code regulate arbitration in general and in particular the manner in which the arbiters are to be selected. The provision for arbitration in the Regulations does not comply with the rules of either of these Codes. The government's answer to this may be that the State, as one of the parties to the controversy, is not bound by the Commercial Code and that the general rules in the Code of Civil Procedure for appointing a panel have been superseded by the special rules of the Regulations. But does not Colombian law provide for an impartial forum to decide state/private citizen disputes? Little impartiality can be expected under the Regulations when three of the four arbiters represent government agencies. The government's answer will probably be that the panel's award is not final since it may be appealed in the administrative courts. If this be so then what of the question of procedural economy? Why compel the parties to expend both time and money on a hearing which in all probability will simply confirm the opinion of the Exchange Office?

Overhanging these issues is an important policy question. Is the purpose of the arbitration panel to impose the government's opinion on value over the value arrived at through arms-length buy-seller negotiations? Probably not. The underlying purpose seems to be to prevent buy-seller collusion whereby the price is inflated and a portion of the overvalue secretly paid back to the buyer in foreign exchange outside of Colombia, thus circumventing the exchange control laws. The problem might certainly be a real one. However it is unfortunate that good faith foreign investors must bear the adverse consequences of this selection of means of ferreting out wrongdoers.

A number of important questions raised by Decision 24 and Decree 1299 are left unanswered in the Regulations. The questions flow from Article 7 of both Decision 24 and Decree 1299 which states that sale of shares from one foreign investor to another shall not be considered as an exportation of capital. The key terms "foreign investor" and "ex-

portable capital" are respectively defined. The first is said to be the owner of a "direct foreign investment" which, basically, is imported capital or capital in the form of local currency which could lawfully have been remitted abroad. Exportable capital is defined as the initial and all additional direct foreign investments less losses.

If the sale of shares by one foreign investor to another is not an exportation (repatriation) of capital then the exportable capital remains undiminished. Is the purchaser of the shares subrogated to the registration and hence possesses the right to repatriate the registered capital upon the dissolution of the company or the re-sale of the shares? Tested against hypothetical situations an affirmative answer leads to conflicts with other parts of the laws.

a) The purchaser, a foreigner, who has no prior investment in Colombia, makes payment outside of Colombia in a foreign currency directly to the seller. Is the purchaser a foreign investor as defined in the laws and Regulations?

b) The purchaser qualifies as a foreign investor as defined in the laws and Regulations. The purchase price is paid in Colombian pesos which the purchaser had no right to remit, for example with excess profits over the 14% remittable. Is the purchaser now the owner of the exportable capital previously owned by the seller? If so, he has converted frozen or blocked funds into repatriable funds.

### *Divestment of Equity Interest*

Nothing is added by the Regulations. Some existing doubts under the law are left unclarified. The most important of these relate to the exception to divestment granted to foreign companies which destine 80% or more of the production to exports to countries outside the Andean Sub-Region. Whether this applies both to foreign companies which existed in Colombia on and subsequent to June 30, 1971, the date on which Decree 1299 became effective, is left unanswered. Also unclear is what sanctions if any, will be applied to a company which for reasons beyond its control is unable in any given year or years to export the 80%.

### *Importation of Technology*

The Regulations in Article 25 restate in modified form the rule that contracts covering the importation of technology entered into between a



foreign company i.e., a Colombian company less than 50% of whose equity is owned by local investors, and its home office will not be approved. A definition of concepts follow. An affiliate is said to be a company which is controlled or directed either economically, financially or administratively by another company which is called the home office or parent. A subsidiary is a company whose control or direction is exercised by the parent, through or with the approval of one or some of its affiliates, or by companies related to the parent or its affiliates.

Colombia has by employing these definitions, departed from the simpler traditional majority stockholder test,<sup>11</sup> obviously in order to cover more realistic circumstances of intercompany control or subordination. This is indeed congruent with ANCOM policy vis-à-vis foreign investors.

On the practical side, the use of these relationship criteria necessarily carries with it the problems of conceptual vagueness inherent in the criteria and the difficulty of identification. Three fairly obvious adverse consequences may well affect foreign investors. First, since in all probability the burden of proof of the non-existence of these relationships will rest with the foreign investor, he will be hard put to ascertain what evidence must be presented to substantiate their non-existence. For instance, how does one establish absence of financial control as distinct from economic control? When are two companies "connected?" When they have overlapping boards of directors? When there is an incidence of common ownership of some stock or the cross-licensing of patents? Second, the government will, at least initially, enjoy a measure of latitude in deciding whether any of the relationships exist in a given case. Third, it will occasionally be essential to reveal information on companies which are not doing business in Colombia.

The new Commercial Code effective as of January 1972 utilizes the same definitions for affiliates and subsidiaries. Article 260 of the Code considers affiliates and subsidiaries as examples of subordinated companies. Interestingly the Code in Article 261 spells out a number of situations in which a company is deemed to be subordinated.

a) When 51% or more of the capital is owned by a parent company either directly, or through, or jointly with its subsidiaries or with its second tier affiliates or subsidiaries.

b) When any of the companies in a) above individually or jointly have the right to issue the number of votes necessary to establish a minimum decision making quorum in stockholders or director meetings of the company.

c) When inter-connected companies participate in 50% or more of the profits of the company, whether this occurs as a result of the rights attached to equity held or by special agreement.

Companies are deemed inter-connected when common or reciprocal economic, financial or management ties exist between them, as well as in any situation of control or dependence.

These examples of subordination shed some light on the scope of some of the terms used in the Regulations. To what extent recourse will be made to the Commercial Code examples may not be stated with certainty. There exist precedents for this in other areas of the law. For instance there is a tendency on the part of the National Office of Taxes to resort to the Commercial Code for examples of a "permanent establishment" in Colombia for purposes of determining source of income. This may occur in connection with the Regulations.

### *Excepted Investments*

Perhaps the part of the Regulations awaited with keenest expectation was that related to Chapter III of decree 1299. This Chapter sets forth the discretionary power of the ANCOM countries to afford exceptional treatment to companies engaged in the businesses specified in the Chapter. Article 44 of the Regulations states:

In accordance with the provisions of Article 44 of Decision 24 of the Commission of the Cartagena Agreement which was implemented by Decree 1299 of 1971, the sectors of the economy referred to in Articles 40 to 43 inclusive, of said Decision, shall be governed by internal legislation and the special norms set forth in the following articles.

The excepted sectors of the economy are thus removed from the overall requirements of Decree 1299 and are to continue to be subject to the existing legislation. However, the Regulations do set out special rules for these industries. Herein lies the rub. The rules for some of the industries are stringent and virtually cancel out existing internal legislation.

#### a) Mining

In effect, Article 49 provides that in major mineral exploration, exploitation and processing projects where the local private or state economic interest is less than that of the foreign investor, the decision on the request for investment approval must take into consideration the possibility

of increasing local participation and decision making power, within the periods agreed upon by the parties. Apparently some type of divestment is contemplated but on the more flexible basis of mutual agreement.

An interesting twist is introduced as to the maximum amount of profits remittable. Article 50 states that foreign investors in mining shall have the rights set forth in Article 16 i.e., a maximum 14% annually on registered capital investment, but then adds that the National Council of Economic and Social Policy, on a case by case basis, may increase this percentage. Is this tie-in to maximum remittable profits under Article 16 necessary if investments in mining are to be governed by existing internal legislation and said legislation (Decree-Law 444) permits this same Council to increase the remittable profits? Article 9 of Decree 688 authorizes the Council to increase the annual percentage from the fixed normal maximum of 10%.<sup>12</sup> Herein lies the difference. Under the Regulations the starting point of an increase by the Council is 14% whereas under the decree that point is 10%. There is a slight advantage involved here. Should the Council under the power granted it by Decree 688 decide to lower the normal maximum back to the 10% provided for under that decree, the mining sector would be unaffected.

b) Exploration and exploitation of natural gas

Repatriation of capital of foreign investments in these activities is subject to the Regulations.<sup>13</sup> But remittance of profits is not subject to the limitation contained in the Regulations. However the profits must be remitted during the year immediately following the year in which earned.<sup>14</sup>

External debts arising from the importation of foreign exchange, technical services and other expenses incurred and attributable to the Colombian operations will be treated as non-interest bearing foreign obligations.<sup>15</sup> Amortization is to be limited to 10% annually.

c) Refining, transport and distribution of petroleum derivatives

Article 48 contains some of the most ambiguous language found in the Regulations. New direct investment in companies involved in these activities will be permitted if "connected to" a national company. The troublesome concept is "*vincularse*" i.e., to tie to or be connected to. In the law of contracts the concept has a clear meaning, namely "to be bound." However with respect to a capital investment it lacks any established legal meaning.

As an exception to this rule, whatever the rule may be, foreign companies existing on the date of the Regulations may make new direct investments if necessary in order to operate with economic and technical efficiency. Obviously this exception makes a great deal of sense if foreign companies are to remain competitive.

d) Insurance companies.

Article 54 effectively excludes any new direct investments from abroad. New investments in the form of retained earnings of existing companies is allowed but only if the company has at least 75% local ownership and the investment does not lower this percentage.

e) Banks

The situation of investments in the commercial banking sector is better than that of insurance companies, but only slightly. Article 58 permits new direct investments in existing mixed and national banks, provided the mixed or national character is not changed as a result. If made in a foreign bank, the bank must agree to convert to a mixed bank within 10 years from the date of the Regulations.

These limitations are subject to the generic limitation that, except for transitory situations, the total participation of foreign investments in the paid in capital and legal reserves of the aggregate of commercial banks may not exceed 10%. The future growth of foreign investments is inextricably tied to either the general expansion of commercial banking or the decision of some foreign investor banks to pull out of Colombia.

f) Internal transportation, television, advertising, commercial radio broadcasting, newspaper and magazine publishing.

No new direct foreign investments will be allowed, Article 62.

g) Domestic wholesale or retail trade

Article 63 states no new companies will be allowed in which foreign capital participates. Apparently existing companies such as Sears Roebuck will be allowed to make reinvestments.

h) *Tourism*

Although investment approval must be obtained, the Regulations contain no limitations or restrictions on investments in this area.

## Carryover of Pre-ANCOM Foreign Investment

### *Rules and Regulations*

Colombia is the only ANCOM member which had an established and functioning comprehensive system of laws and regulations governing various aspects of foreign investments. Many of these rules were simply carried over into the Regulations. For instance, the criteria to be employed in evaluating a potential investment remain the same, except for the one relating to the contribution of the investment on the process of sub-regional and Latin American integration. The same is true to a major extent as to the criteria to be used in evaluating a contract for the importation of technology. The rules for valuating an investment have not changed substantially as is true of the rights arising from the registration of an investment.

### *Conclusions*

Unquestionably Colombia has tempered the severe stance taken by ANCOM Commission Decision 24. The process began with Decree 1299 and is accelerated in the Regulations. However, this attitude is not reflected across the board but rather in a selective manner. For investments in those sectors of the economy to which Decision 24 is to be applied in full the Regulations actually tighten the rules. Witness for example the definition of "net profits", the criteria for defining subsidiaries and affiliates, and the power of the Office of Foreign Exchange to challenge the remittable purchase price. Even in the areas where the Regulations spell out an abandonment of Decision 24 i.e., excepted investments, the approach has been a measured one, with exception of investments in tourist activities and to lesser extent those in the mining sector.

### NOTES

<sup>1</sup>See generally, Garcia Amador, Latin American Economic Integration, 2 Lawyer of the Americas, 445-449 (Oct. 1970); McDermontt and Wieland, Latin American Economic Integration, 10 Va. J. Int'l. L. 139-179 (Dec. 1969).

<sup>2</sup>Under Resolution 9/68 of the National Council of Economic and Social Policy, regulating Decree-Law 444 of 1967, the definition of net profits expressly recognizes those arising from the sale of company assets.

<sup>3</sup>Colombian income tax laws utilize a system quite similar to the U.S. Internal Revenue Code in distinguishing between property held in a trade or business and capital assets.

<sup>4</sup>Corporations pay a top income tax of 36% on excess profits tax, a 6% Housing tax and a 3% Electricity tax, all imposed on income.

<sup>5</sup>The Exchange rate for the peso is determined by the market price of exchange certificates. The devaluation rule for 1971 is expected to be from 11-12%.

<sup>6</sup>Art. 17 of the Regulations.

<sup>7</sup>A mixed company is one incorporated in Colombia and in which the capital belonging to Colombians is between 51-80%. A national company is likewise incorporated in Colombia and 80% or more of its capital is owned by Colombians.

<sup>8</sup>Regulations, Article 1.

<sup>9</sup>Decree 1299, Article 4.

<sup>10</sup>Article 14(b), second paragraph.

<sup>11</sup>Law 81 of 1960 lumps both affiliates and subsidiaries together and defines them as companies 50% or more of whose shares are held by another company which is considered the parent.

<sup>12</sup>By Resolution 7/68 the National Council of Economic and Social Policy did in fact raise the maximum across the board to 14%.

<sup>13</sup>Article 46.

<sup>14</sup>Article 47.

<sup>15</sup>Article 46.